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UNCLAS SECTION 01 OF 03 BRASILIA 002751

SIPDIS

NSC FOR MIKE DEMPSEY
STATE PLEASE PASS TO USTR FOR SCRONIN
DEPT OF TREASURY FOR SSEGAL
USDOC FOR 4332/ITA/MAC/WH/OLAC/SHIELDS
USDOC ALSO FOR 3134/ITA/USCS/OIO/WH/RD/CREATORE
USDA FOR FAS/ITP AND FAS/FAA/WH
STATE PASS OPIC FOR MORONESE, RIVERA, MERVENNE

E.O. 12958: N/A
TAGS: ECON ETRD BR
SUBJECT: BRAZIL: WAGES REMAIN STAGNANT EVEN WHILE ECONOMY EXPANDS

REF: Brasilia 2447

¶1. (SBU) Summary and Introduction. In recent months, the macroeconomic picture for Brazil has been especially bright. Growth has been strong, inflation has remained in check, exports have increased sharply, and the trade balance and the current account (both positive) have come in higher than expected. This good news, however, masks a disturbing trend. Per capita income growth for 2004 is likely to be anemic (around 0.4 percent), and unemployment, while declining slightly, remains at historically high levels. This small increase in per capita income growth comes in the wake of a whopping 7.4 percent decrease in real wages per worker in 2003. Indeed, comparing 2003 figures to those in 1996, real wages per worker were nearly 20 percent less (852 Brazilian reais versus 692) and unemployment was more than 100 percent higher. It appears that the lower middle class has borne the brunt of this wage and employment squeeze. There is hope that improvements in these indicators during 2004 might signal the end of this long slide, particularly if current economic growth is sustained into the medium term. End Summary and Introduction.

¶2. (U) With GDP growth predicted to come in at 4.5 to 4.7 percent this year (as opposed to -0.2 percent in 2003), the GOB economic team is receiving plaudits from both industry and the market for its ability to restart economic growth. The country's economic expansion has brought advances on all fronts: 2004 exports are predicted to reach a record high (USD 90 billion, up from 73 billion the previous year), and the trade balance, originally forecast at USD 23 billion for 2004, should fall somewhere between the USD 30 and 32 billion level. Meanwhile, the current account is expected to be positive (USD 9.5 billion) and consumer prices remain under control (forecast to rise 7.16 percent for 2004). This positive economic news has enthused market risk watchers. Moody's, Standard & Poor's and Fitch's have all raised their rating of Brazilian debt, with GOB bond issues now 3 to 4 categories below investment grade.

¶3. (U) Notwithstanding the GOB's achievements this year on the growth, trade, and inflation fronts, these advances come against the background of mid-term reductions in both real wages per worker and employment. According to data from the Brazilian Institute for Geography and Statistics for calendar year 2003, compared to 1996 (the tail end of the Plano Real boom) real wages per worker declined from R$ 852 per month to $R 692 per month - nearly 20 percent. Meanwhile, unemployment, again according to IBGE figures, rose from 5.4 percent to 12.3 percent during this period (although methodological changes for measuring job losses put in place in 2002 distort this comparison). The drop in real wages was particularly sharp during the first year of the Lula government, 2002 to 2003, when this figure dropped a whopping 7.4 percent. (During this same time-frame, unemployment rose from 11.7 percent to 12.3 percent.) Even with the economy currently in full recovery mode, post estimates that for 2004 real income per worker will likely only rise in the 0.3 to 0.4 percent range - hardly sufficient to make much of a dent in the decline over the past 8 years.

¶4. (SBU) In a recent conversation with EconCouns, ECLAC economist Carlos Mussi offered an

explanation for the drop in wages/employment between 1996 and 2003. In 1996, he opined, though the economy's macro numbers were good, in reality the over-valued exchange rate meant that growth was unsustainable. With the real trading more or less on par with the dollar Brazilian consumers had artificially enhanced purchasing power. This fed increases in imports, which combined with the difficulty exporters had in selling their products overseas, created current account problems. The GOB's response - sky-high interest rates - led to stagnant growth and higher unemployment. The excess of number of job seekers allowed employers to hold the line on salaries, and, in some industries (such as retail banking) even cut pay. Workers were hit with yet another body blow when consumer prices increased (7.7 percent in 2001, 12.5 percent in 2002, and 9.3 percent in 2003), further eroding their incomes. The good news, Mussi declared, was that even though workers were less well off today than they were in 1996, with all indicators in balance now at least the economy has a chance to experience sustainable long-term growth. While the real wage and unemployment numbers were better in 1996, the disequilibrium in the economy then doomed the country to a start-stop pattern in terms of expansion.

¶5. (SBU) Mussi felt that the middle-class has borne the brunt of the wage and employment squeeze, and IBGE data appear to confirm this. Unemployment rates remain high in the major metropolitan centers where the middle class is concentrated (for September 2004, 8.8% in Rio and 11.7% in Sao Paulo). While as a whole real wages per worker sank 7.4 percent between 2002 and 2003, for the top half of the population wages declined 8 percent - as opposed to a mere 4.2 percent for the bottom half. Indeed, between 2002 and 2003 workers at the bottom of the scale earning between one and two monthly minimum salaries (at that time, 240 to 480 reais) experienced no real wage losses at all. Comment. While Mussi did not explicitly address this point, the rise in unemployment between 1996 and 2003 also highlights the difficulties of small and medium-sized enterprises in generating job growth. With middle and working-class incomes being squeezed, entrepreneurs with small and medium-sized enterprises who normally might have devoted their disposable funds to investment found that they had precious little to put back into the businesses. The result: stagnant growth in employment generation.

¶6. (SBU) Comment Continued. Nevertheless, there are a couple of encouraging notes in this tableau of statistics. The first is that the still-evolving social safety net for the poor helped keep them from losing any ground during this period of sliding incomes among the middle classes. The second observation, although not yet sustained into the longer term, is that the slide in real incomes looks to have halted in ¶2004. There is hope, given the more sustainable policy mix in 2004 vs. 1996 (i.e., floating exchange rate coupled with responsible fiscal and monetary management and healthy external accounts) that the Brazilian middle class will continue to see real income gains. Current GDP growth is more sustainable -- albeit at more moderate rates than in 2004. Realizing that goal, however, will require continued GOB focus on the microeconomic and structural reform agenda necessary to increase both investment and productivity.

Danilovich